CHARLES ELMORE CROPLE
CLERK

Supreme Court of the United States

OCTOBER TERM, 1951.

No. 284

LEON FALK, JR.,

Petitioner,

against

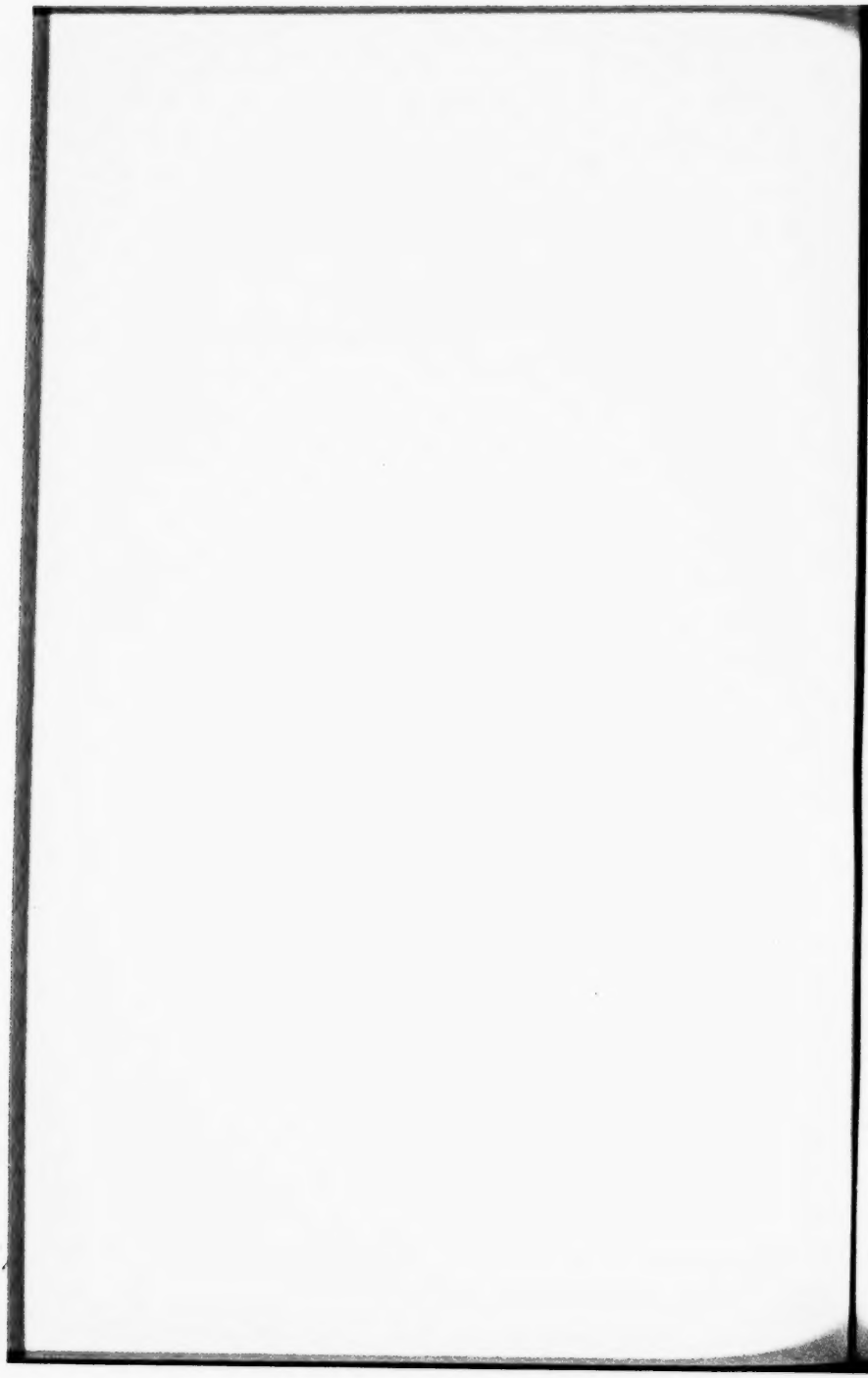
COMMISSIONER OF INTERNAL REVENUE,

Respondent.

PETITION FOR WRIT OF CERTIORARI.

LOUIS CAPLAN,
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CHARLES C. MACLEAN, JR.,
RAY I. HARDIN,
Of Counsel.



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2. *The court below erred in disregarding (a) an important Congressional purpose, expressed in the provisions of Sections 4(a) and 162(a) of the Internal Revenue Code, as to the taxation of trust income distributed to charities, and (b) the holding of Old Colony Trust Co. v. Comm'r, 301 U. S. 379 (1937), giving that policy full effect in the case of trust income distributed to charities pursuant to the exercise of a discretionary power*	19
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Supreme Court of the United States

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No.

LEON FALK, JR.,

Petitioner,

against

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

PETITION FOR WRIT OF CERTIORARI.

To the Honorable the Chief Justice of the United States and the Associate Justices of the Supreme Court of the United States:

Petitioner prays that a writ of certiorari be issued to the United States Court of Appeals for the Third Circuit to review a judgment of that Court rendered in the above case on June 5, 1951 (R. 83) affirming a decision of The Tax Court of the United States that there was a deficiency in the petitioner's income and victory tax for the taxable year 1943 in the amount of $39,564.54 (R. 74a).

Petitioner submits that the Court of Appeals committed errors of law in reaching a result contrary to applicable statutory provisions, not in accord with applicable decisions of this Court, and in conflict with applicable local decisions and statutes.

Summary Statement of the Matter Involved.

The decision below held that the petitioner, who is a member of one of the leading philanthropic families of Pittsburgh, Pennsylvania, was taxable on a portion of the net income, amounting to approximately $76,000, of an inter vivos trust created in 1927 by his father, which income was not received by the petitioner but, in accordance with the terms of the deed of trust, was distributed in 1942 and in 1943 to charitable and educational institutions.

Under the terms of the deed of trust, the trustee was directed each year after the donor's death, until the termination of the trust, to distribute the trust income, *first,* to the petitioner's sister in such amounts as the petitioner should from time to time in writing designate (but not less than $5,000 per annum), *second,* to charitable, benevolent and educational institutions in such amounts as the petitioner should from time to time in writing designate, and, *third,* to the petitioner any balance of the income remaining after distributions to the petitioner's sister and to charitable, benevolent and educational institutions.

By the terms of the trust, the donor, whose principal activity at the time was philanthropy, retained during his life the power to terminate the trust and deprive the petitioner of any interest therein. During his life the donor required the petitioner to promise that he would use the power of designation given him by the trust instrument to carry on for the donor after his death his share of the family program of charitable giving. Petitioner gave the promises required on a number of occasions, the last such occasion being when his father was arranging his affairs preparatory to entering the hospital where he died a short time later. Having received the promises he requested, the donor died without having exercised his power to terminate the trust and deprive the petitioner of any interest therein.

After his father's death, the petitioner did exercise the power of designation in compliance with the promises given his father and, in carrying out his promises, directed distribution by the trustee of approximately two-thirds of the trust income to charitable and educational institutions. A total of approximately $500,000 was paid directly or indirectly from the net income of the trust from October 20, 1928 to March 18, 1946 to charitable and educational institutions.

The decision below held, contrary to applicable Pennsylvania judicial decisions and statutes, that no court could have called the petitioner to account if he had been faithless to the promises he had given his father.

Based upon this holding, the decision below further held that the amounts distributed to charitable and educational institutions in accordance with the terms of the deed of trust were taxable to the petitioner, notwithstanding (a) that the petitioner was not the donor of the trust, (b) that Congress has provided in Section 162(a) I. R. C. that trust income which, "pursuant to the terms of the will or deed creating the trust, is during the taxable year paid or permanently set aside" for charitable and educational institutions shall not be subject to tax, either to the trust or any beneficiary thereof, and (c) that this Court has held in *Old Colony Trust Co.* v. *Comm'r,* 301 U. S. 379 (1937), that Section 162(a) applies to payments made to charities pursuant to a discretionary power contained in the trust instrument.

Jurisdiction.

The jurisdiction of this Court is invoked under Section 1254(1) of the Judicial Code (28 U. S. C. §1254(1)) and

§1141(a) of the Internal Revenue Code (26 U. S. C. §1141(a)).

Opinions of the Courts Below.

The opinion of the Tax Court (R. 57a-74a) is reported in 15 T. C. 49. The opinion of the Court of Appeals for the Third Circuit (R. 76) is reported at 189 F. 2d 806.

Statutes Involved.

The relevant statutes are set forth in the Appendix hereto (pp. 26-29, *infra*).

Questions Presented.

1. Whether the court below, basing its decision as to petitioner's income tax liability on the court's interpretation of the Pennsylvania law of trusts, erred in holding, contrary to the decision of the Orphans' Court of Allegheny County, Pennsylvania, in construing the deed of trust here involved, that under Pennsylvania law no court could have called the petitioner to account if he had betrayed the trust placed in him by his father and had been unfaithful to the promises he made with respect to payments to charitable and educational institutions.

2. Whether the court below erred in disregarding the Congressional mandate, contained in Sections 4(a) and 162 of the Internal Revenue Code, that trust income distributed to charities pursuant to the exercise, by one other than the grantor, of an express power in favor of charities should not be taxed under Section 22(a) but should be deductible in full under Section 162(a) in determining the amount of trust income taxable to the trust and its beneficiaries.

Statement of Facts.

The question here presented involves a trust, created in 1927 by the petitioner's father, an outstanding citizen and philanthropist of Pittsburgh, providing for certain payments to charitable and educational institutions in each year for the duration of the trust (R. 19a-21a, 41a-45a, 62a).

In 1919, the petitioner's father, Leon Falk, who was about to remarry, executed two trusts, one in favor of his daughter, Marjorie Falk, and a similar one in favor of the petitioner (R. 25a, 26a, 46a-48a). To each of these trusts, Leon Falk conveyed approximately one-quarter of his property (R. 26a). The trustee of each trust was the donor's brother, Maurice Falk (R. 5a). Each trust was revocable by the donor with the consent of the beneficiary (R. 48a; Doc. No. 12, Ex. 3). The revocation of the trust in favor of the daughter under the circumstances described below gave rise to the creation of the trust whose income is here in question (R. 27a).

The donor, Leon Falk, and his brother, Maurice Falk, had started in business together in Pittsburgh and had continued in business there together for many years, sharing the same office (R. 18a-19a, 61a). The various businesses in which they were interested and from which they derived their wealth were carried on in the general vicinity of Pittsburgh (R. 19a, 61a-62a).

After they retired from active participation in directing their various business enterprises, the two brothers devoted the greater part of their time to philanthropic work in Pittsburgh, in which work they had for many years been active (R. 19a-21a, 62a). Their relationship was very close and they carried on this philanthropic work jointly as a "team" (R. 19a-20a, 29a-30a, 62a). They were among the

largest contributors to charity in Pittsburgh (R. 19a, 21a, 31a, 62a).

Included in the many special gifts of Leon Falk and Maurice Falk to charity were joint contributions of $100,000 to the building fund of the Montefiore Hospital in Pittsburgh, $100,000 to the building fund of the Y. M. H. A. and Y. W. H. A. in Pittsburgh, $100,000 to the building fund of the Cathedral of Learning at the University of Pittsburgh and $500,000 to the creation of the Falk Clinic at the University of Pittsburgh. After the death of Leon Falk in 1928, his brother Maurice established the Falk Foundation, a $10,000,000 charitable and educational foundation (R. 62a).

After the petitioner's graduation from college in 1924, he went into the office with his father and uncle (R. 9a-10a, 21a, 62a). He was the only male member of the family of his generation and his father and uncle undertook to train and direct him to carry on the family activities, both business and philanthropic (R. 21a-22a, 62a). Their relationship was extremely close and the petitioner's father "was accustomed to giving [him] very explicit instructions all the time" (R. 21a, 36a).

In the fall of 1927, the petitioner's sister, who was then 23 years of age, returned from a European trip and announced her intention of marrying a man she had met abroad and establishing her residence in France (R. 26a-27a, 60a). To this her father objected, as he wished his daughter to participate in the community life of Pittsburgh, and the money which he had acquired there during his lifetime to be spent in Pittsburgh and not transferred to Europe (R. 27a, 60a). As a result, and with her consent, he terminated the trust of which his daughter was the beneficiary and she assigned to him the entire corpus of the trust (R. 27a, 49a, 60a). He then transferred all of these

assets to a new trust (the trust involved in these proceedings and sometimes hereinafter referred to as the "1927 trust") on November 11, 1927 (R. 26a-27a, 60a).

The donor's brother, Maurice Falk, was designated as the trustee of the trust, which was to continue until the death of the survivor of the donor and the petitioner (R. 41a, 44a, 60a). It was terminable by the donor during his life but became irrevocable upon his death (R. 43a, 60a). The donor took no beneficial interest in the trust, whether upon termination by him or otherwise (R. 41a-45a).

The trustee was directed under the deed of trust to distribute the income in the following sequence: First, to the donor's daughter, such portion of the income as the donor (or the petitioner, after the donor's death) should from time to time in writing direct (with a minimum amount of $5,000 per annum after the donor's death); second, to charitable, benevolent and educational institutions, such amounts as the donor (or the petitioner, after the donor's death) should from time to time in writing designate "each year until the trust is terminated"; and third, to the petitioner, all of the income not so paid to the donor's daughter or for charitable, benevolent and educational purposes (R. 42a-43a).

The donor, in the presence of his attorney, Charles M. Thorp, who witnessed the instrument of October 31, 1927 terminating the 1919 trust, and who likewise witnessed the deed of trust of November 11, 1927, told Maurice Falk and the petitioner that he desired the net income of the new trust to be applied first to take care of the needs of his daughter if the necessity should arise, and second, to carry on the donor's share of the family program of charitable giving and to maintain a memorial for his first wife (including the establishment of a new memorial for her in the event that the existing one was closed), and that after

these purposes were accomplished, any undistributed balance might be paid to the petitioner (R. 25a, 28a-30a, 36a-39a, 45a, 49a, 62a-63a, 68a-69a). Any benefits to the petitioner were to be purely incidental (R. 29a). Both the petitioner and the trustee, Maurice Falk, promised the donor that they would carry out his instructions (R. 29a-30a).

At the time of the creation of the 1927 trust, the petitioner, then 25 years of age, was receiving income in excess of $50,000 a year, including approximately $37,000 a year from the trust created for his benefit by his father in 1919, and his sister was receiving income totaling about $13,000 a year from her grandfather's estate and from the estate of an uncle (R. 3a, 27a-28a). In December 1927, the sister married the man she had told her father about and established her home in Paris (R. 27a).

On a number of occasions following the creation of the 1927 trust, the donor repeated to the petitioner his instructions as to the manner of distributing the income of the trust, including an occasion just a month before his death in October 1928, when the donor spent an afternoon going over his affairs generally with the petitioner in preparation for his entering the Mayo Clinic, where he died (R. 18a, 28a-31a). The petitioner on such occasions promised to follow these instructions and the donor died without having exercised his power to deprive the petitioner of any interest in the 1927 trust by terminating it (R. 4a, 29a-30a, 43a).

During the period of eleven months which elapsed between the creation of the trust of November 11, 1927 and the death of the donor on October 20, 1928, the sum of $23,250 out of a total trust income of $36,000 was distributed at the donor's direction to charitable, benevolent and educational institutions (R. 5a, 31a). In addition, at

the donor's direction, securities worth approximately $75,000 were withdrawn from the principal of the trust and paid over to the University of Pittsburgh for charitable purposes (R. 31a-32a).

Following his father's death, the petitioner, as he had been instructed and had promised to do, exercised the power of designation under the 1927 trust so as to carry on his father's participation in the charitable activities which his father had carried on jointly with Maurice Falk prior to his death (R. 5a, 15a-16a, 20a-21a, 63a). In so exercising the power of designation, the petitioner consulted with Maurice Falk until the latter's death eighteen years later on March 18, 1946 (R. 32a).

The petitioner also followed after his father in engaging actively in philanthropic and community activities in Pittsburgh, serving at times as president of the Community Chest, president of the Federation of Jewish Philanthropies, Chairman and trustee of the Falk Foundation (the $10,000,000 charitable and educational foundation established by Maurice Falk) and trustee of the University of Pittsburgh (R. 13a, 15a-16a, 58a, 62a).

The petitioner, in exercising the power of designation under the 1927 trust, followed closely the pattern which had previously been set by his father. His father had directed the payment of approximately 65% of the income to charitable and educational institutions (R. 5a, 31a). The petitioner thereafter through the years here in question and down to his uncle's death directed the payment to such institutions of over $504,000 out of the total net income of the trust for the period of $793,000, or 63% of such net income (R. 5a, 6a, 33a, 63a; Doc. No. 12, Ex. 6).

The charitable and educational beneficiaries designated by the petitioner were substantially the same as those designated by the donor, the principal ones being (i) the Com-

munity Fund (otherwise known as the United Fund, the Welfare Fund and the United War Fund), which included the Federation of Jewish Philanthropies, (ii) organizations for the relief of refugees overseas, such as the United Jewish Fund, and (iii) the University of Pittsburgh (R. 38a-39a, 52a-53a; Doc. No. 12, Ex. 6). These three main objects of philanthrophy, in which the donor had been interested, received together in excess of 90% of the total distributions made for charitable and educational purposes during the 18-year period after the donor's death (Doc. No. 12, Ex. 6).

Following the death of Maurice Falk, his executors, in order to free his estate from liability, filed in the Orphans' Court of Allegheny County, Pennsylvania, the first and final account of Maurice Falk, as trustee under the deed of trust of Leon Falk, dated November 11, 1927 (R. 33a-34a, 66a; Doc. No. 12, Ex. 6). By order of the court, dated September 18, 1946, it was adjudged that the petitioner herein "is required to exercise a reasonable, fair and legal discretion in carrying out the provisions of the said Section 2 of Article Second of the said Deed of Trust and his use of such discretion is subject to supervision and review by this court" (R. 66a; Doc. No. 12, Ex. 6). It was further adjudged that Maurice Falk, as trustee, "was required to exercise reasonable care to assure the proper performance by the said Leon Falk, Jr. of the latter's duties under the said Section 2 of Article Second of said Deed of Trust," and Arthur M. Scully, a prominent Pittsburgh lawyer and banker, was appointed trustee *ad litem* to represent the interests of all charitable, benevolent and educational institutions under the provisions of the deed of trust at the audit of such account (R. 66a; Doc. No. 12, Ex. 6). The trustee *ad litem* made a thorough examination of the affairs of the trust and filed a report dated November 18, 1946

recommending confirmation of the account (R. 34a, 50a-56a). After submission of the report, the Orphans' Court, on December 6, 1946, entered a decree confirming the account absolutely and discharging the estate of Maurice Falk from all liability in connection with the administration of the trust (Doc. No. 12, Ex. 6).

The account was filed before the deficiency notice herein was issued but after the revenue agent had first raised a question in connection with his audit as to the taxability to the petitioner of distributions made by the trust to Marjorie Falk and to charitable and educational institutions (R. 40a; Doc. No. 2, Ex. A; Doc. No. 12, Ex. 6).

The deficiency notice here in question determined that the petitioner was taxable on all amounts distributed by the trust to the petitioner's sister in excess of $5,000 per annum and on all amounts distributed by the trust to charitable and educational institutions during 1942 and 1943 (Doc. No. 2, pp. 19, 21).

The Tax Court held that the Commissioner's determination was incorrect in so far as the petitioner had directed payments to his sister in excess of $5,000 per annum in accordance with his promise to his father to make his sister's support and welfare a first charge against the trust estate, saying (R. 74a):

> "It seems clear and we so hold that the petitioner's sister had a right to receive additional income over and above the minimum of $5,000 provided, if her needs required this additional payment, and that her rights were subject to enforcement in a court of equity."

The Commissioner has acquiesced in this holding by the Tax Court (1950-25 I. R. B. 1).

The Tax Court, however, further held, and the Court of Appeals affirmed the holding, (i) that neither the terms

of the trust instrument, nor the promises made by the petitioner to his father, created any enforceable duty on the part of the petitioner to appoint trust income to charitable and educational institutions, and (ii) that, in the absence of any such duty, the petitioner was taxable on the income distributed to such institutions, subject to a charitable deduction within the 15% limit provided by Section 23(o) I. R. C.

Reasons for Granting the Writ.

1. The decision of the court below is based upon an interpretation by the court of the Pennsylvania law of trusts which is in conflict with the construction placed upon this deed of trust by the Orphans' Court of Allegheny County and with other applicable Pennsylvania decisions and statutes relating to charitable trusts and the enforceability of constructive trusts.

If the decision of the court below is permitted to stand, the petitioner will be required to pay an income and victory tax of approximately $39,500 on funds amounting to approximately $76,000 of which the petitioner did not receive a single penny and every dollar of which was paid to charitable and educational institutions. It is submitted that this penalization of the petitioner results from a misconstruction by the court below of the Pennsylvania law applicable to the deed of trust involved in this case.

The Orphans' Court of Allegheny County, in construing this very deed of trust, held, in conformity with what petitioner believes to be the Pennsylvania law on the subject, that the petitioner is required to exercise a legal discretion in carrying out its provisions and that his use of such discretion is subject to judicial review. The court below held to the contrary.

There is no issue as to the facts in this case. The source of the property forming the corpus of the 1927 trust and the circumstances of its creation are undisputed. The trust *res* came from an earlier trust which the donor had created for his daughter and which he had terminated promptly on learning that she intended to leave the United States and did not intend to follow his wishes as to the use to be made in Pittsburgh of the trust income.

Neither is there any dispute as to the fact that the donor retained during his life the power to terminate the trust and required unequivocal promises both from the trustee and from the petitioner as to the use which would be made of the authority under the trust instrument to direct the payment of trust income to the donor's daughter and to charitable and educational institutions.

If the petitioner had refused to give the donor the promises requested and had told the donor that he would instead divert all the trust income to himself, it is inconceivable that the donor would have allowed the new trust to stand. But the petitioner did not refuse to give the promises requested and the donor, confident that his instructions as to distributions to charitable and educational institutions would be followed, allowed the trust to continue and died in the full confidence that the son whom he had trained to carry on his charitable program after him could be trusted to do so.

It is established beyond question in Pennsylvania that equity will not permit a beneficiary who has obtained property under such circumstances to repudiate his promises, particularly where, as here, a confidential relationship exists between the donor and the beneficiary by reason of close kinship or customary trust or reliance. In such cases the courts of Pennsylvania will impose a constructive trust or will enforce the oral trust. *Metzger* v. *Metzger,* 338 Pa.

564, 14 A. 2d 285 (1940), a conveyance from a son to his mother; *Lalich* v. *Bankovsky,* 350 Pa. 441, 39 A. 2d 514 (1944), deed from brother to sister; *In re Washington's Estate,* 220 Pa. 204, 69 A. 747 (1908); *In re Hoffner's Estate,* 161 Pa. St. 331, 29 A. 33 (1894); *Restatement, Trusts,* §55 (1935); *Restatement, Restitution,* §186 (1937).*

The general rule was recently stated in *In re Brenneman's Estate,* 360 Pa. 558, 63 A. 2d 59, 61 (1949), although the occasion for its application was not there presented, as follows:

> "It is a well settled principle that when a testator makes a devise absolute in its terms, but upon an oral agreement that the devisee will apply the devised estate to some lawful purpose designated by the testator, a court of equity will enforce the trust; * * * A constructive trust is imposed under such circumstances to prevent unjust enrichment rather than merely to carry out the intent of the testator; * * * There is no question that this is the applicable rule of law."

Furthermore, to prevent unjust enrichment, a constructive trust will be raised by a court of equity in favor of charitable beneficiaries just as in the case of private

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* Since oral trusts of personal property are valid in Pennsylvania (*Gribbel* v. *Gribbel,* 341 Pa. 11, 17 A. 2d 892 (1941); *In re Free's Estate,* 327 Pa. 362, 194 A. 492 (1937)) there is no objection based on the Statute of Frauds to the consideration of oral declarations of trust.

Even in the case of real property, an oral trust would be enforced under such circumstances in Pennsylvania, as is shown by the *Metzger* and *Lalich* cases, cited in the text, which held the mother-son and the brother-sister relations to give rise to a confidential relationship. Such situations were held to be cases in which "a trust or confidence shall or may arise or result by implication or construction of law" within the meaning of an express exception to the Statute of Frauds (§4 of the Act of April 22, 1856. P. L. 532, 33 Purdon's Statutes, §2).

beneficiaries. For example, see *Restatement, Trusts,* §359 (1935), which states the rule:

> "Where a testator devises or bequeaths property to a person in reliance upon his agreement to hold the property upon a charitable trust, the devisee or legatee holds the property upon a constructive trust for the charitable purposes for which he agreed to hold it."

Comment (b) under that section further states:

> "It is immaterial whether the agreement of the devisee or legatee was made prior to or at the time of or after the execution of the will, provided that it was made at some time before the death of the testator. An agreement which induces the testator to refrain from revoking his will is as effective as an agreement which induces him to make a will.
>
> "It is immaterial whether the agreement by the devisee or legatee was in specific words, whether written or oral, or was shown by his conduct. Thus, if the intention of the testator to create a charitable trust is communicated by him to the devisee or legatee and he does not refuse to hold the property upon the intended charitable trust, his mere silence is ordinarily a sufficient indication of his agreement to hold the property upon the intended charitable trust."

Nor does the fact that the charitable trust here involved is indefinite as to amount render it unenforceable. There are many cases in which a discretion, indefinite as to amount, has been held subject to judicial review. Thus it appears in *Eva* v. *Townsend,* 5 T. C. 1380 (1945), that the taxpayer's exercise of a power (which was in part a beneficial power) had been reviewed and, in fact, upset by the Orphans' Court of Allegheny County. For other

instances of judicial supervision of discretionary powers see *In re Briggs' Estate,* 150 Pa. Super. 66, 27 A. 2d 430 (1942); *In re Brown,* 345 Pa. 373, 29 A. 2d 52 (1942); *In re Harrar's Estate,* 244 Pa. 542, 91 A. 503 (1914); *Erisman* v. *Directors of the Poor,* 47 Pa. 509 (1864); *Saurmann's Estate,* 57 Montg. Co. L. R. 61 (1940). See also *In re Martin's Estate,* 135 Pa. Super. 136, 4 A. 2d 551 (1939); *In re Neeb's Estate,* 263 Pa. 197, 106 A. 317 (1919); *In re Pearson's Estate,* 251 Pa. 612, 97 A. 71 (1916).

Although the courts are slow to interfere with the exercise of an honest discretion, any abuse of discretion is subject to judicial review as the above cases show. In the present case, the circumstances surrounding the creation of the trust and leading up to the vesting of the powers of designation in the petitioner afford a standard, or yardstick, which facilitates judicial review and supervision, consisting of the example set by the donor in the charitable activities carried on by him during his lifetime and in his own exercise of the power prior to his death.

As the petitioner testified (R. 39a) in referring to the donor's exercise of the power of designation, "I think we had a pattern there that we followed." The donor had directed the payment of approximately 65% of the income of the trust during his lifetime to charitable and educational institutions. The petitioner thereafter, through the years here in question and down to his uncle's death eighteen years after the creation of the trust, directed the payment to such institutions of $504,000, or approximately 63% of the net income of the trust for that period. The close relation of the petitioner's use of the power of designation to that of the donor is further shown by the particular charities to which payments were made.

There can likewise be no doubt that the fact that the trust was in favor of indefinite charitable beneficiaries did not

relieve the petitioner of a duty to account. Such a trust is perfectly valid and enforceable. *Restatement, Trusts,* §§364, 391 (1935). The distinction between charitable trusts and private trusts in this respect is stated in 3 *Scott, Trusts,* 1966-1967 (1939), as follows:

> "§364. *Indefinite beneficiaries.* The most important distinction between a private trust and a charitable trust is with reference to the beneficiaries. As has been stated, a private trust is not valid unless there is a beneficiary who is definitely ascertained at the time of the creation of the trust or definitely ascertainable within the period of the rule against perpetuities. In the case of a private trust no one except a beneficiary or one suing on his behalf can maintain a suit to enforce the trust. In the case of a charitable trust the beneficial interest is not given to individual beneficiaries, but the property is devoted to the accomplishment of purposes which are beneficial or are supposed to be beneficial to the community, and *the persons who are to receive benefits from the trust need not be designated.* A charitable trust is enforceable at the suit of the Attorney General, and ordinarily is not enforceable at the suit of any individual beneficiary, although in the case of some charitable trusts there may be beneficiaries having such a special interest in the performance of the trust as to entitle them to maintain a suit to enforce it." (Italics added.)

These rules are well established in Pennsylvania. *In re Anderson's Estate,* 269 Pa. 535, 112 A. 766 (1921), applying Section 1 of the Act of May 23, 1895, P. L. 114 (10 *Purdon's Statutes* §13) hereinafter referred to; *In re Thompson's Estate,* 282 Pa. 30, 127 A. 446 (1925), where the bequest was to "such religious and charitable purposes, objects and institutions as may commend themselves to my said executors"; *In re Funk's Estate,* 353 Pa. 321, 45 A.

2d 67 (1946), where the bequest was to "some worthy cause or institution"; *In re Jordan's Estate,* 329 Pa. 427, 197 A. 150 (1938), where the bequest was "to charity."

Nor are charitable trusts favored in Pennsylvania by judicial decisions only. On the contrary, the legislature of the State has expressly provided, through the passage of Section 10 of the Act of April 26, 1855, P. L. 328, as amended by Section 1 of the Act of May 23, 1895, P. L. 114 (10 *Purdon's Statutes* §13) (quoted in the Appendix hereto), that no disposition of property made for any religious, charitable, literary or scientific use shall fail for want of a trustee or by reason of the objects being *indefinite, uncertain* or ceasing, or depending upon the *discretion* of a last trustee, and that it shall be the duty of any orphans' court or court of equity having jurisdiction in the county to supply a trustee and by its decree to carry into effect the intent of the donor or testator so far as the same can be ascertained and carried into effect consistent with law or equity. The statute provides for the institution of proceedings by leave of the Attorney General of the State on the relation of any institution or association not for profit or individual desirous of carrying such disposition into effect.

It is apparent that under these authorities the Orphans' Court of Allegheny County was required to hold, as it did on the accounting of the trustee of the trust here in question, that the petitioner was subject to judicial control and supervision with respect to the very power of designation here involved. Certainly this decision was entitled to full respect as expressing the applicable Pennsylvania law.

The decision of the Court of Appeals that the petitioner could not have been held accountable if he had been faithless to the promises made to his father is, therefore, in conflict both with Pennsylvania judicial decisions and with

Pennsylvania statutes. It is also in conflict with the Tax Court's holding in this very case, acquiesced in by the Commissioner, that the petitioner's exercise of discretion with respect to payment of trust income to his sister, beyond the specified minimum, is subject to judicial review (R. 74a).

2. The court below erred in disregarding (a) an important Congressional purpose, expressed in the provisions of Sections 4(a) and 162(a) of the Internal Revenue Code, as to the taxation of trust income distributed to charities, and (b) the holding of Old Colony Trust Co. v. Comm'r, 301 U. S. 379 (1937), giving that policy full effect in the case of trust income distributed to charities pursuant to the exercise of a discretionary power.

The court below, having found that, if the petitioner had taken the trust income for himself, he could not have been held accountable (except for such amounts as his sister's needs might require to be distributed to her), went on to hold that he was taxable on all the income of the trust (except the amounts distributed to his sister) under the provisions of Section 22(a) I. R. C. In so doing the court below ignored the provisions of Section 4(a) I. R. C., although neither it nor the Commissioner offered any reason to justify it in so doing. Since Section 4 is the key to the structure of the income tax provisions of the Code, the failure of the Court of Appeals to consider its provisions has resulted in the frustration of an expressed Congressional policy with respect to the taxation of trusts and trust beneficiaries.

It will be seen that Sections 11 to 64 of the Code are designated as "General Provisions" which, so far as the provisions therein are concerned, are applicable to all taxpayers without exception, and that the Code also contains Sections 101 to 424, which are among those designated as "Supplemental Provisions" and refer principally to special

classes of taxpayers. Their provisions are largely inconsistent with the general provisions contained in Sections 11 to 64, including in particular the provisions of Section 22(a) which were relied on by the court below. Any conflict between the General Provisions and the Supplemental Provisions is resolved by Section 4, which provides that the application of the General Provisions to each of the special classes of taxpayers listed in Section 4 "shall be subject to the exceptions and additional provisions found in the Supplement applicable to such class."

The first special class of taxpayers listed in Section 4 includes "trusts and the beneficiaries thereof," to which the provisions of Supplement E (§§161-172 I. R. C.) are made applicable.

Consequently, to hold, as the court below did, that the absence of a fiduciary duty gives the petitioner sufficient control over the income of the trust to render it the petitioner's gross income within the meaning of the provisions of Section 22(a) overlooks the fact that Section 22(a) has no application here. Under Section 4(a) the taxability of income of a trust to the beneficiaries thereof must be determined under Supplement E to which the provisions of Section 22(a) are expressly made subject.*

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* The provisions of Section 4(a) relate only to estates and trusts and their beneficiaries, and do not relate to the grantors of trusts. Petitioner, however, was not the grantor of the trust. There have been a few cases in which trust beneficiaries were taxed on trust income under the provisions of Section 22(a), but none of these cases involved discretionary charitable powers and in none of them were the provisions of Section 4 called to the court's attention. Beyond this, however, the beneficiaries had such extensive powers over the trust corpus in those cases that, having allowed the trusts to continue, they might with reason be regarded as standing in the position of grantors of the trusts. See *Jergens* v. *Comm'r,* 136 F. 2d 497 (5th Cir. 1943); *Mallinckrodt* v. *Nunan,* 146 F. 2d 1 (8th Cir. 1945); *Emery* v. *Comm'r,* 156 F. 2d 728 (1st Cir. 1946); *Bunting* v. *Comm'r,* 164 F. 2d 443 (6th Cir. 1947); *Comm'r* v. *Newman,* 159 F. 2d 848 (2d Cir. 1947), and *Stix* v. *Comm'r,* 152 F. 2d 562 (2d Cir. 1945).

Examination of the provisions of Supplement E will show that it contains many exceptions to the provisions of Section 22(a). Of particular application here is the provision of Section 162, contained in Supplement E, that, in taxing the net income of a trust, in lieu of the limited charitable deduction allowed by Section 23(o), there may be deducted *without limitation* any part of the trust income "which pursuant to the terms of the will or deed creating the trust, is during the taxable year paid or permanently set aside for the purposes and in the manner specified in section 23(o)."

This Court has held in *Old Colony Trust Co.* v. *Comm'r*, 301 U. S. 379 (1937), that to obtain this deduction it is not necessary for the trust instrument definitely to direct the charitable contributions which are claimed as deductions and that amounts paid for charitable purposes, in accordance with a *discretionary* power to pay to charity contained in the trust instrument, qualify for the deduction under §162(a) as "paid or permanently set aside" for charitable purposes during the year "pursuant to the terms of the will or deed creating the trust." The Court said (pp. 383-384):

> "We are asked to hold that the words 'pursuant to' mean directed or definitely enjoined. And this notwithstanding the admission that Congress intended to encourage charitable contributions by relieving them from taxation. *Lederer* v. *Stockton*, 260 U. S. 3; *United States* v. *Provident Trust Co.*, 291 U. S. 272, 285.
>
> " 'Pursuant to' is defined as 'acting or done in consequence or in prosecution (of anything); hence, agreeable; conformable; following; according.'
>
> "The words of the statute are plain and should be accorded their usual significance in the absence

> of some dominant reason to the contrary. We find nothing in the regulations or practice of the Treasury Department or in the general purpose of the statute which requires the narrow meaning advocated by respondent. Neither the Commissioner nor the Board of Tax Appeals accepted or mentioned with favor the interpretation which his counsel now advance; and this is hardly compatible with the theory of controlling rulings or practice by the Bureau.
>
> "The questioned donations were made by the petitioners in pursuance of the trust deed."

Similarly, Section 162 taxes to trust beneficiaries only the portion of the income of the trust "which is to be distributed currently" to them or "which is properly paid or credited" to them. Since the full amount of the charitable contributions was, under the express terms of the trust instrument (R. 42a-43a), to be deducted in determining the amount of the income to be distributed to the petitioner, the portion of the income paid to charities was neither "to be distributed currently" to the petitioner, nor was it "paid or credited" to him.

In the audits of the petitioner's income tax returns for years prior to the taxable year here in question, the Commissioner has agreed with the position here taken by the petitioner, *viz.*, that the petitioner is taxable on only that part of the net income of the trust "which is to be distributed currently" to him or "which is properly paid or credited" to him. Thus, on the audit of the petitioner's returns for 1935, 1936 and 1937 the only charitable distributions by the trust which the Commissioner sought to tax to the petitioner were those claimed to have been constructively paid to the petitioner, *viz.*, distributions

which served to relieve the petitioner of a contingent liability based on a personal guaranty by him of payments to be made from trust income to the University of Pittsburgh (R. 5a, 6a, 24a, 65a-66a). Accordingly, one-half (but only one-half) of the distributions made in those years to the University of Pittsburgh under the pledge was held to be taxable to the petitioner, while the other half of such distributions was held to be taxable to his sister as relieving her of a like contingent liability since she had joined in the guaranty (*id.*). That position is entirely inconsistent with the Commissioner's position in the present case in which he seeks to tax the petitioner on *all* distributions by the trust to charitable and educational institutions.

The exceptions made in the case of trust beneficiaries to the application of Section 22(a) represent a deliberate Congressional purpose on an important question of policy which is thwarted by the decision below. There is an important question of tax policy *whenever* income is received by an entity which is controlled by, or holds the income for the ultimate benefit of, one or more other entities. As, for example, income received by a corporation, partnership or trust is subject to control by, or is held for the ultimate benefit of, one or more individuals interested therein. Yet Congress has not provided that the stockholders of a closely held corporation are taxable on the corporation's income even where it is perfectly plain that such stockholders could have ordered all the income paid out as a dividend. Instead the income is taxed to the corporation (occasionally at higher than ordinary rates where circumstances indicate that income is being accumulated for tax avoidance purposes). On the other hand, in the case of a partnership the ultimate beneficiaries are

taxed on their share of the partnership income (whether received or not) and no tax whatever is imposed on the partnership.*

Congress has for good reason deliberately taken an intermediate view in the case of trusts. There the income is taxed either to the trust or to the beneficiary, depending on the specific rules contained in Supplement E. In particular, Congress has provided that trust income which "pursuant to the terms of the will or deed creating the trust, is during the taxable year paid or permanently set aside" for charitable and educational institutions shall not be subject to tax either to the trust or to any other beneficiary of the trust (Section 162(a) I. R. C.). And this Court has construed that section in accordance with its terms, holding it applicable where the payment made was discretionary under the terms of the trust (*Old Colony Trust Co.* v. *Comm'r, supra*). (The charitable beneficiaries are themselves, of course, exempt from tax on such payments under Section 101(6) I. R. C.)

Congress' solution of this question of tax policy in the case of trusts and their beneficiaries is expressly provided for by Section 4(a) I. R. C. which constitutes them a special class of taxpayers to be taxed under the special provisions of Supplement E. In their case the application of Section

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* The overriding power of Congress to determine tax policy was recently reaffirmed by this Court, in a different context, in *United States* v. *Cumberland Public Service Co.*, 338 U. S. 451 (1950), where it said (pp. 454-456): "While the distinction between sales by a corporation as compared with distribution in kind followed by shareholder sales may be particularly shadowy and artificial when the corporation is closely held, Congress has chosen to recognize such a distinction for tax purposes. * * * *Congress having determined that different tax consequences shall flow* from different methods by which the shareholders of a closely held corporation may dispose of corporate property, *we accept its mandate.*" (Italics added.)

22(a) I. R. C. and the doctrine of "unfettered command" which has been read into that section are, by Congressional direction, subject to the exceptions and additional provisions of Supplement E.

The decision of the Court of Appeals holding petitioner taxable on trust income distributed to charities in accordance with the terms of the trust instrument is therefore in conflict both with the provisions of Sections 4(a) and 162(a) of the Internal Revenue Code and with the holding of this Court in *Old Colony Trust Co.* v. *Comm'r, supra,* that no exception is to be read into Section 162(a) with respect to distributions to charities made under discretionary powers.

Conclusion.

The petition for a writ of certiorari should be granted.

Respectfully submitted,

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August 27, 1951.

Appendix.

Internal Revenue Code:

Chapter 1—Income Tax.

Subchapter A—Introductory Provisions.

* * * * * *

SEC. 4. SPECIAL CLASSES OF TAXPAYERS.

The application of the General Provisions and of Supplements A to D, inclusive, to each of the following special classes of taxpayers, shall be subject to the exceptions and additional provisions found in the Supplement applicable to such class, as follows:

(a) Estates and trusts and the beneficiaries thereof,—Supplement E.

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Subchapter B—General Provisions.

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SEC. 22. GROSS INCOME.

(a) GENERAL DEFINITION.—"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service (including personal service as an officer or employee of a State, or any political subdivision thereof, or any agency or instrumentality of any one or more of the foregoing), of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. * * *

* * * * * *

SEC. 23. DEDUCTIONS FROM GROSS INCOME.

In computing net income there shall be allowed as deductions:

* * * * * *

(o) CHARITABLE AND OTHER CONTRIBUTIONS.—In the case of an individual, contributions or gifts payment of which is made within the taxable year to or for the use of:

* * * * * *

(2) a corporation, trust, or community chest, fund, or foundation, created or organized in the United States * * *, organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes, or for the prevention of cruelty to children or animals, no part of the net earnings of which inures to the benefit of any private shareholder or individual, and no substantial part of the activities of which is carrying on propaganda, or otherwise attempting, to influence legislation;

* * * * * *

to an amount which in all the above cases combined does not exceed 15 per centum of the taxpayer's net income as computed without the benefit of this subsection or of subsection (x). * * *

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Subchapter C—Supplemental Provisions.

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Supplement E—Estates and Trusts.

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SEC. 162. NET INCOME.

The net income of the estate or trust shall be computed in the same manner and on the same basis as in the case of an individual, except that—

(a) There shall be allowed as a deduction (in lieu of the deduction for charitable, etc., contributions authorized by section 23(o)) any part of the gross income, without limitation, which pursuant to the terms of the will or deed creating the trust, is during the taxable year paid or permanently set aside for the purposes and in the manner specified in section 23(o), or is to be used exclusively for religious, charitable, scientific, literary, or educational purposes, or for the prevention of cruelty to children or animals, or for the establishment, acquisition, maintenance or operation of a public cemetery not operated for profit;

(b) There shall be allowed as an additional deduction in computing the net income of the estate or trust the amount of the income of the estate or trust for its taxable year which is to be distributed currently by the fiduciary to the legatees, heirs, or beneficiaries, but the amount so allowed as a deduction shall be included in computing the

net income of the legatees, heirs, or beneficiaries whether distributed to them or not. As used in this subsection, "income which is to be distributed currently" includes income for the taxable year of the estate or trust which, within the taxable year, becomes payable to the legatee, heir, or beneficiary. Any amount allowed as a deduction under this paragraph shall not be allowed as a deduction under subsection (c) of this section in the same or any succeeding taxable year;

(c) * * * in the case of income which, in the discretion of the fiduciary, may be either distributed to the beneficiary or accumulated, there shall be allowed as an additional deduction in computing the net income of the estate or trust the amount of the income of the estate or trust for its taxable year, which is properly paid or credited during such year to any legatee, heir, or beneficiary, but the amount so allowed as a deduction shall be included in computing the net income of the legatee, heir, or beneficiary;

* * * * * *

PENNSYLVANIA STATUTE:

Section 10 of Act of April 26, 1855, P. L. 328, as amended by Section 1 of Act of May 23, 1895, P. L. 114 (10 *Purdon's Statutes* §13):

§13. *Disposition to religious or charitable use not to fail for want of trustees; cy pres proceedings.* No disposition of property heretofore or hereafter made for any religious, charitable, literary or scientific use shall fail for want of a trustee, or by reason of the objects being indefinite, uncertain or ceasing, or depending upon the discretion of a last trustee, or being given in perpetuity or in excess of the annual value hereinbefore limited, but it shall be the duty of any orphans' court, or court having equity jurisdiction in the proper county, to supply a trustee, and by its decrees to carry into effect the intent of the donor or testator, so far as the same can be ascertained and carried into effect consistently with law or equity; for which purpose the proceedings shall be instituted by leave of the attorney general of the commonwealth, on the relation of any institution, association, corporation not for profit or individual, desirous of carrying such disposition into effect,

and willing to become responsible for the costs thereof, subject to an appeal as in other cases in said courts respectively, and to be reviewed, reversed, affirmed or modified by the supreme court of this state; but if the objects of the trust be not ascertainable, or have ceased to exist, or such disposition be in excess of the annual value permitted by law, or in perpetuity, such disposition, so far as exceeding the power of the courts to determine the same by the rules of law or equity, shall be taken to have been made subject to be further regulated and disposed of by the legislature of this commonwealth, in manner as nearly in conformity with the intent of the donor or testator and the rules of law against perpetuities as practicable, or otherwise to accrue to the public treasury for the public use: Provided, That this act as amended shall not apply to any case which has been adjudicated prior to the adoption of this amendment.